Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Related Bills:	See Legislative History	Telephone:	845-6979	Introduced Date:	February 26, 2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Energy Reducing Devices Credit

SUMMARY

This bill would allow a 25% credit for an energy-reducing device that uses significantly less energy than other comparable devices.

PURPOSE OF THE BILL

The purpose of this bill appears to be to provide financial incentives to encourage energy conservation.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2001.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are needed to clarify the definition of energy-reducing devices and to clarify the certification process for this credit. See “Implementation Considerations” below. Department staff is available to assist the author with these or any other amendments.

ANALYSIS

FEDERAL/STATE LAW

Federal law currently provides two energy-related credits: an energy credit that is one portion of the investment credit and a business credit for the production of electricity from certain renewable resources.

The energy investment credit is equal to 10% of the basis of energy property placed in service during the taxable year. Energy property includes equipment that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat. It also includes equipment that produces, distributes, or uses energy derived from geothermal deposits. The equipment must meet performance and quality standards prescribed by federal regulations.

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The business credit for the production of electricity from certain renewable resources is equal to 1.5 cents multiplied by the kilowatt hours produced by the taxpayer's qualified energy resource and facility. To qualify, the energy is required to be sold to an unrelated person during the taxable year. Qualified energy resources include wind, closed-loop biomass, and poultry waste.

Prior federal law allowed a credit equal to 15%, up to a maximum total credit of $300, for the purchase and installation of energy-savings components in an individual's residence. The qualifying expenditures included such items as:

- energy efficient furnace burners and electrical or mechanical furnace ignition systems; and
- storm or thermal windows or doors, and caulking or weather-stripping of exterior doors or windows.

A separate federal credit equal to 40% of the costs, up to a maximum total credit of $4,000, was allowed for tax years 1979-1986. That credit was based on the purchase and installation of renewable energy equipment, such as solar energy systems, and wind and geothermal energy equipment. The renewable energy equipment was required to be installed in an individual's primary residence located in the United States. The equipment must have been new when installed and have had a useful life of at least five years.

Prior state law allowed a credit equal to a percentage of the cost of energy conservation measures. The credit was amended a number of times during its lifetime and was available for tax years 1977-1986. In later years, the credit for residential property was 40% of allowable costs for tax years 1981-1983 and 35% for tax years 1984-1986. Energy measures that qualified for the credit were similar to those in the federal credit.

If the federal credit was allowed on the same costs, the state credit was reduced by the amount of the federal credit. For residential properties, the combined federal and state credits could not exceed 40% of the cost. For nonresidential properties, the combined federal and state credits could not exceed 40% of the cost, except where the cost exceeded $6,000. In this case, the federal credit was limited to 25% of costs, and the state credit was reduced by the amount of the federal credit. The state credit was limited to a maximum of $1,500. In addition, the state credit could not be claimed if the amount of state credit for any given year would have been less than $10.

The energy conservation credit could not be claimed for costs on which the solar energy credit was also claimed.

THIS BILL

This bill would allow a 25% credit for the amount paid or incurred for an "energy-reducing device."

The bill provides that the California Energy Resources Conservation and Development Commission (CERCDC) would determine the devices that use significantly less energy than other comparable devices. The CERCDC would certify those devices to the Franchise Tax Board (FTB) as being energy-reducing devices for purposes of this credit.

Any excess credit could be carried forward to subsequent years.

IMPLEMENTATION CONSIDERATIONS

This bill would raise the following implementation considerations. Department staff is available to assist the author with any necessary amendments.

This bill requires the CERCDC to determine and certify to FTB those devices that use significantly less energy than comparable devices. However, it is unclear whether the CERCDC would certify a particular taxpayer's purchase or whether CERCDC would certify a list of devices from which taxpayers could choose what device to purchase. Typically, credits that involve issues for which the FTB does not possess technical expertise provide that another agency certify the credit. The certification language would specify the responsibilities of both the certifying agency and the taxpayer.

The bill requires the CERCDC to determine that an energy-reducing device uses "significantly less energy" than comparable devices. However, the bill does not provide a definition for this term. Without a clear definition taxpayers may dispute the definition used by CERCDC. Department staff could be caught in the middle of disputes between taxpayers and CERCDC since FTB would administer the credit.

Credits are typically based on a percentage of the "cost" paid or incurred for the acquisition or installation of a particular item. This credit is based on the amount paid or incurred for a device, with no clarity regarding the particular costs eligible for the credit. Further, the bill does not specify whether the energy-reducing device must be new or whether the credit would apply to used or refurbished items.

LEGISLATIVE HISTORY

AB 873 (Takasugi, 1997/1998) would have allowed a 40% credit for the cost of energy conservation measures. The bill also would have allowed a second credit equal to 10% of the cost of a solar energy system installed on premises located in California and used for commercial purposes, subject to certain requirements. The bill failed to pass the Assembly Revenue and Taxation Committee.

AB 1269 (Campbell, 2001/2002) is identical to this bill. AB 1269 is in the Assembly Revenue and Taxation Committee.

AB 15X (Rod Pacheco, 2001/2002) would allow a 100% credit for the purchase of energy conservation measures that reduce electricity and natural gas used by a taxpayer by 5% from the previous taxable year. AB 15X failed passage but was granted reconsideration in the Assembly Revenue and Taxation Committee.

AB 27X (Koretz, 2001/2002) would allow multiple credits for the purchase and lease of a power generation system, an accelerated depreciation deduction for a power generation system, and a claim for refund from the Board of Equalization. AB 27X is in the Assembly Appropriations Committee.

SB 17X would allow a credit equal to an applicable percentage for the purchase and installation of a solar energy system for the production of electricity. SB 17X was passed from the Senate to the Assembly and is at the Assembly desk.

OTHER STATES' INFORMATION

Massachusetts: Currently has an energy credit that is equal to 15% of the net expenditures or $1,000 whichever is less.

Michigan: Does not allow an energy-related credit, but exempts the value of energy conservation devices from local property tax.

New York: For personal income tax only, New York allows a 25% credit for solar generating equipment expenditures. The credit is capped at $3,700 per system. New York also allows industrial or manufacturing businesses a refundable credit for certain taxes paid on energy.

Oregon: Currently has two energy credits, a personal income tax credit for consumer energy purchases and a corporate tax credit for the costs of energy projects. The consumer energy purchases credit allows various credits ranging from $50 to $1,500 for consumer purchases of certain items. The corporate credit for the costs of energy projects is a credit equal to 35% of the incremental costs of the project involving energy conservation and other related projects.

FISCAL IMPACT

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

Due to lack of specifications in the bill, the magnitude of revenue losses are speculative at this time, but could easily be on the order of $300 million annually beginning in 2001-02.

<u>Tax Revenue Discussion</u>

The revenue impact of this bill would be determined by the amount of costs incurred by taxpayers for energy-reducing devices and the amount of credits that could be applied to reduce tax liabilities.

Energy-reducing devices and costs that may be claimed as credits by taxpayers are unlimited under the bill as currently drafted. Examples of such devices can range in cost from a few dollars for a lighting-control device (dimmer) to several thousand dollars for a new energy-efficient furnace or air conditioner in a home to hundreds of thousands of dollars or more in a commercial facility.

There are roughly 11.6 million residential units and nearly 425,000 non-governmental and non-tax-exempt commercial buildings in California. In addition, there are over a million business enterprises in California.

If one in 10 taxpayers that own or reside in the roughly 12 million structures, or own or operate one or more businesses, incur qualifying costs of $1,000 on average, credits generated would total $325 million [13 million x 10% x $1,000 x 25%].

ARGUMENTS/POLICY CONCERNS

Public utilities often offer grant programs to encourage people to install and use energy conservation measures or energy efficient appliances. The bill does not require the cost of the device or the credit amount to be reduced by the amount of any financial incentive or grant received.

The bill does not specify that the energy-reducing device must be installed on property located in California or actually used in California for a specified period of time. Credits typically provide for the recapture of the credit amount if specific requirements are not met.

Although the bill would provide a credit for devices that use significantly less energy than other comparable devices, there is no requirement that the device actually reduce energy consumption.

This bill does not specify a repeal date. Credits typically are enacted with a repeal date to allow the Legislature to review the effectiveness of a credit.

This bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment is already allowed in the form of an expense deduction or depreciation deduction. This new credit would have the effect of providing a double benefit for that expense item. On the other hand, making an adjustment to reduce basis in order to eliminate the double benefit creates a state and federal difference, which is contrary to the state's general conformity policy. In the case of a one-time expense deduction, the reduction of that expense would not create an ongoing difference.

The bill does not limit the amount paid for an energy-reducing device or the amount of the credit that may be claimed. Imposing a cap on the credit or the costs eligible for credit, or allocating the credit, could potentially reduce the revenue impact for this bill.

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